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### IRS Penalties Can Feel Cruel, But Are They Ever Unconstitutional?

If you have ever forked over additional taxes, interest and penalties to the IRS, you may have uttered a few choice words. Yet odds are you probably didn't say, "this is unconstitutional." That's good since arguing that IRS penalties are unconstitutional is a loser in almost all cases.

But before you dismiss this as a tax protester rant, consider that many penalties can be big. Common tax penalties amount to 25%, but some ratchet up over time. The civil fraud penalty is 75%. And that's not all. The IRS penalty on responsible persons for payroll taxes is 100%, and that can be assessed against many different individuals.

But all of these penalties are keyed to the amount the government has lost. And they are all constitutional. But what about willful FBAR penalties for failing to report offshore bank accounts?

Now the numbers can get even bigger. For a willful FBAR violation, the penalty can be 50% of the account balance *each* year. That means if you fail to file an FBAR for a \$100,000 offshore account for 4 years in a row? Your penalty is 200% or \$200,000. Is that reasonable?

*First three words of the U.S. Constitution (Photo credit: Wikipedia)*

[Mr. Carl R. Zwerner](#) was recently judged to be willful when he didn't file FBARs. In fact, Mr. Zwerner was saddled with three willful penalties so will have to pay FBAR penalties of \$2,241,809 on an account worth \$1,691,054. In short, the account that all the fuss was about was a lot less than the penalties. See [Florida Man Penalized Record 150% for Swiss Account](#).

Now, the court may end up having to decide the constitutionality point too, although reports suggest the case is settling. If that's so, it may mean this nicely teed up issue will not be decided, at least not this time. The government hasn't traditionally tried to double dip to exceed the account value with FBAR penalties. But Mr. Zwerner's case suggests that was then.

Are FBAR penalties meant to compensate the government or penalize the taxpayer, or both? FBAR penalties are often applied when all taxes have been paid. A case in point was Mrs. Mary Estelle Curran, who paid back taxes of over \$660,000 and an FBAR penalty of \$10.8 million on a \$21.7 million Swiss account. Her FBAR penalty was approximately 16 times the taxes she owed Uncle Sam.

In another case, Beanie Baby creator Ty Warner paid \$53.5 million in FBAR penalties on a bank account worth \$93.6 million. There were big taxes paid too, but the FBAR penalties were more than 50 times Mr. Warner's tax liability. An even bigger multiple—FBAR penalties worth *several hundred times* the tax loss—was paid by Mr. Pius Kampfen in another Swiss account case.

These cases show variations, but they were deals to which taxpayers agreed in connection with criminal cases. It's not likely that most people would agree to penalties equal to 100%, 150% or 200% of their account. Does it begin to sound like forfeiture?

Under the [Eighth Amendment](#), excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted. A civil penalty can be unconstitutional if the punishment is grossly disproportionate to the conduct. In the case of FBARs, there is often no tax loss to the government, since in most cases the taxes are paid, including interest and penalties.

If someone has paid all their back taxes and interest, and even IRS penalties on the back taxes, is it fair to slap on such a big FBAR penalty? In [U.S. v. Bajakajian](#), the Supreme Court said a fine must be proportional. The amount of the forfeiture must bear some relationship to the gravity of the offense it is designed to punish.

Following [Bajakajian](#), Congress modified the statute governing forfeitures to include a proportionality analysis. The law now says that in determining proportionality, courts should compare the forfeiture to the gravity of the offense. If the forfeiture is grossly disproportional to the offense, the court is supposed to reduce or eliminate it.

Are FBAR penalties? It will depend on the facts, of course. But in some cases, where there are few tax dollars lost and the money is lawful, it's worth asking how a 200% penalty would look. Arguing unconstitutionality will be risky and expensive, but it hardly sounds crazy on the right facts.

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